

# The road to Inflation Targeting - Albania

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anniversary of the introduction of IT in the Czech Republic

# Questions to be addressed prior to IT introduction

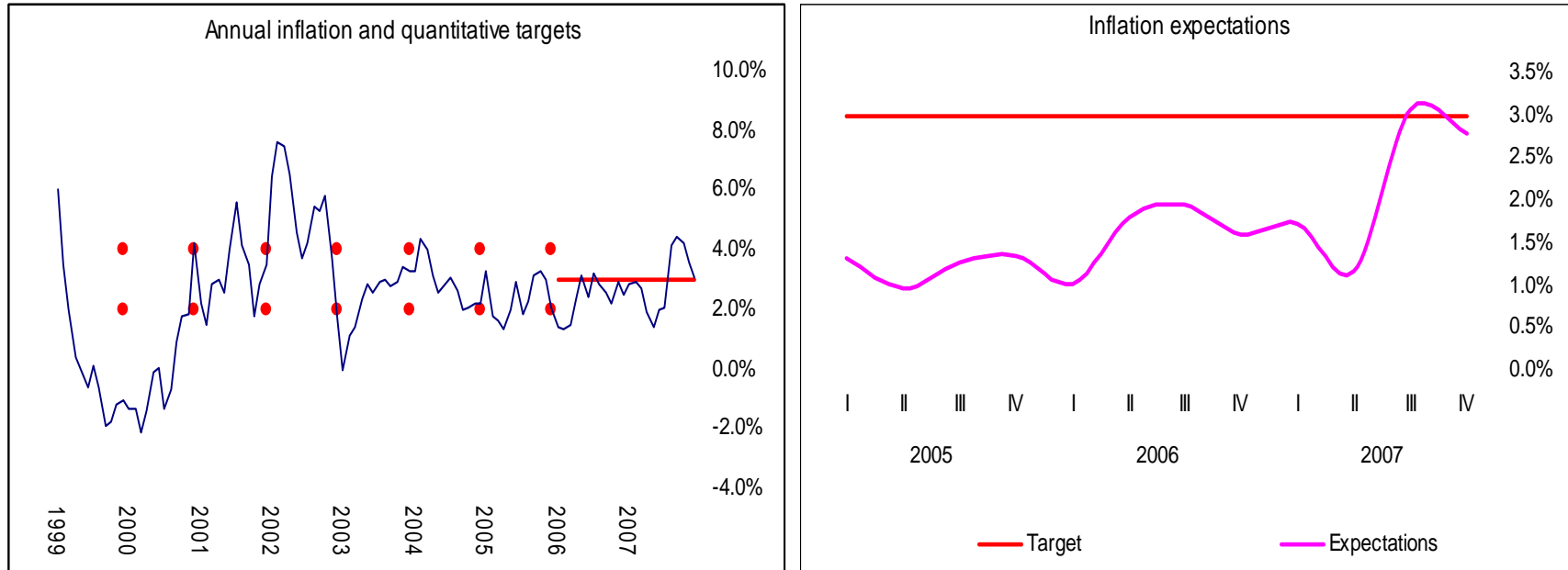
- Part 1. Why do we choose IT?
  - accident?
  - necessity?
  - lack of other options?
- Part 2. How do we envision IT?
  - Flying carpet?
- Part 3. How do we approach IT?
  - Wait for all the preconditions to be fulfilled?

## Part 1. Why IT?

- Not by accident (there is a history)
- This choice is not caused by inflationary pressures. Low and stable inflation of the past is considered as a strong argument in favor of IT.
- External anchor replacing IMF Programs quantitative targets
- Credibility increased due to the successful performance
  - Headline inflation, core inflation (CPI) – Low and stable
  - Inflation forecasts – good performance and improving
  - Inflation expectations well – anchored
  - Public already acknowledges IT as the monetary policy regime (difficult to go back)

# Inflation performance

Headline CPI inflation and inflation expectations (consumer survey)



## Part 2. How do we envision IT?

- Not a magic cure – to solve all problems
- Not a flying carpet – to take us anywhere instantaneously
- A complex, evolving institution with many elements – not a simple rule
- An efficient way to increase transparency and improve accountability
- A regime that should bring incentives to all players
- IT with financial stability as a supporting target (flexible)
- Not a strategy to be followed by the Central Bank alone.

## Major challenges prior to the introduction of IT

- Set of preconditions 1: Institution building
  - Target ownership (price stability – Parliament; definition of quantitative target – BoA)
  - Abolish direct credit to gov't (must)
  - Develop and deepen financial markets (important but a gradual process)
  - Instrument and operational independence (granted to by BoA by current legal framework - will remain so)

# Major challenges prior to the introduction of IT

- Set of preconditions 2: Technical issues
  - Good inflation record (inflation in 1999-2007 low and stable)
  - Money market instruments (measures to ensure gradual development)
  - Understanding of transmission mechanism (still not very clear but not a stringent requirement at the introductory stage)
  - Availability, reliability and quality of data (not good but visible progress)
  - Analytical and forecasting capacity at the central bank (sufficient to introduce IT)

# Albania's experience

## Implicit IT

- Price stability – primary goal of BoA (BoA Law 1997)
- Quantitative inflation target is publicly announced each year (3+/-1%)
- Decision making is based on a wide set of information and quantitative inflation forecasts (not published)
- BoA has taken important steps to increase transparency
  - regular press releases
  - fixed dates of monetary policy decisions
  - inflation report – type of documents
- Accountability – increased (separate sections of regular reports explain past decisions and policy outcomes)



# Albania's experience

- Switch from interval to point target; change from end-of-year target
- Research –more involved
- Three layers of discussion:
  - staff
  - internal MPC-type of Committee – advisor to the Supervisory Council (monthly meetings)
  - regular monthly monetary policy meetings of the Supervisory Council
- Regular press releases (minutes of SC meetings - not published)
- Regular press conferences of the Governor
- Several roundtables and seminars (national & regional; ECB, EC, BIS, IMF, WB, other central banks) Focus: IT, regional cooperation, convergence, supervision and financial stability
- Nationwide education program: target group - high schools, universities, businesses

## How do we approach IT?

- We can't wait for all preconditions to be fulfilled:
  - Data
  - Modeling and forecasting techniques
  - Developed financial markets
- But we will need to:
  - Abolish direct credit to gov't => give incentives to gov't to develop markets and debt mgmt techniques; increase CB independence
  - Establish a mechanism to ensure monetary and fiscal policy coordination; coordination goes beyond agreeing upon respective targets (document in the spirit of IMF Arrangements)
  - Take all the necessary measures to prevent fiscal dominance in the future

## Modified IT?

- BoA will keep an eye on new external (and internal) challenges
  - An increasing inflation environment
  - Increased threat of international financial instability
  - Evolving technology and know-how
- Objective function of Central Bank may be modified to reflect the new environment and challenges
  - Extend forecasting and policy horizon
  - Give more importance to other auxiliary objectives besides price stability
  - Other measures?

## Final remarks

- Pre-accession countries have the same goal (EU)
- And face similar problems
- Address similar monetary policy challenges (underdeveloped markets, fiscal dominance, legal issues, dollarization)

Recommendation: Adopt Maastricht criteria for countries emerging from Fund Programs=>Replace Fund quantitative targets with Maastricht criteria

Objective: Facilitate convergence and assist countries in their journey towards the common accession goal